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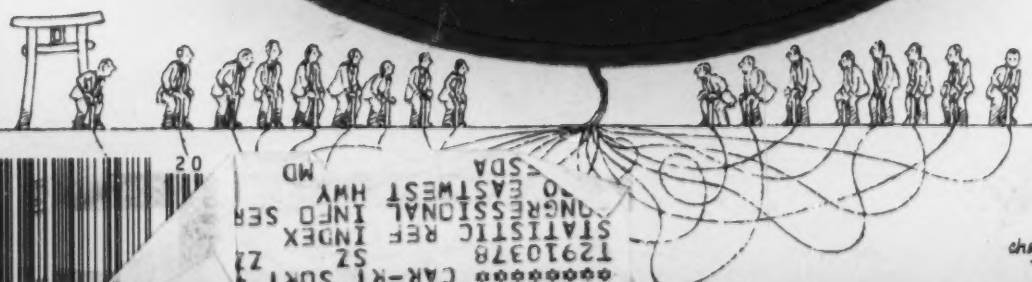
MAY 18, 1987

THREE DOLLARS FIFTY CEN

WILL INTEREST RATES DERAIL THE ECONOMY?

Forbes

ZEN AND THE ART OF JAPANESE STOCK PRICING



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Forbes

MAY 18, 1987
VOLUME 139
NUMBER 11

40 *Great profits*

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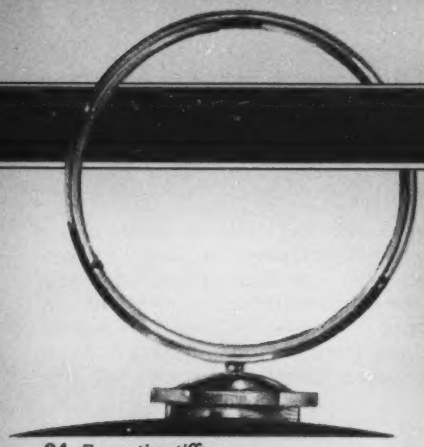

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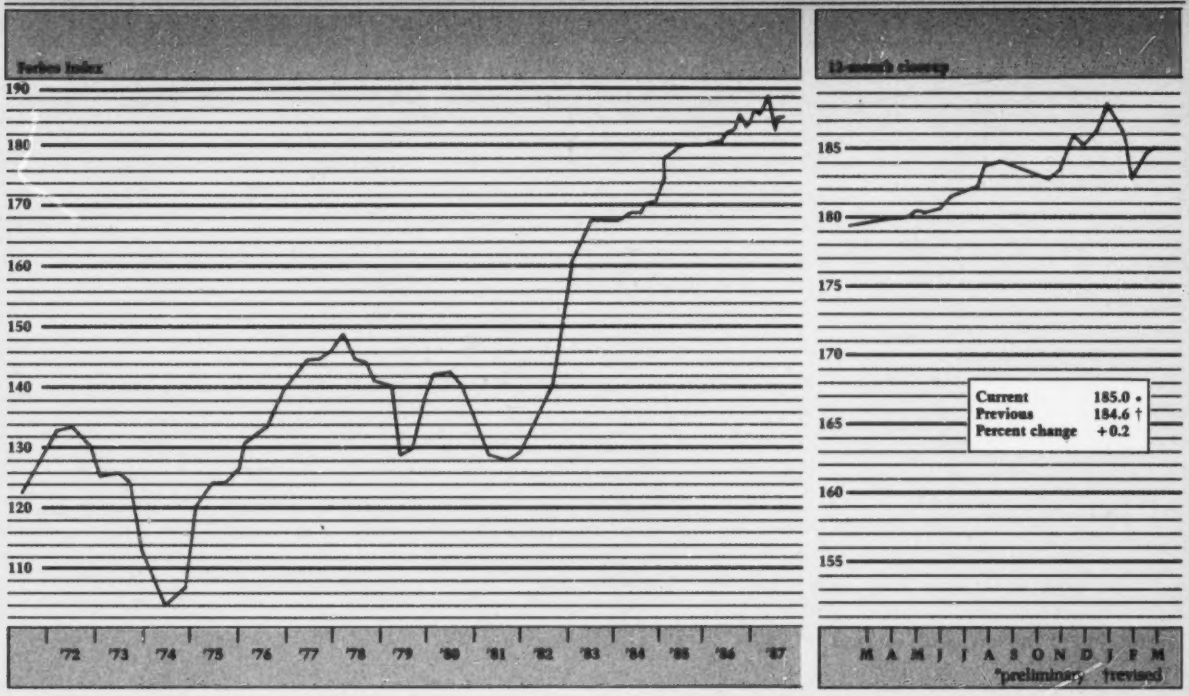
The Forbes Index



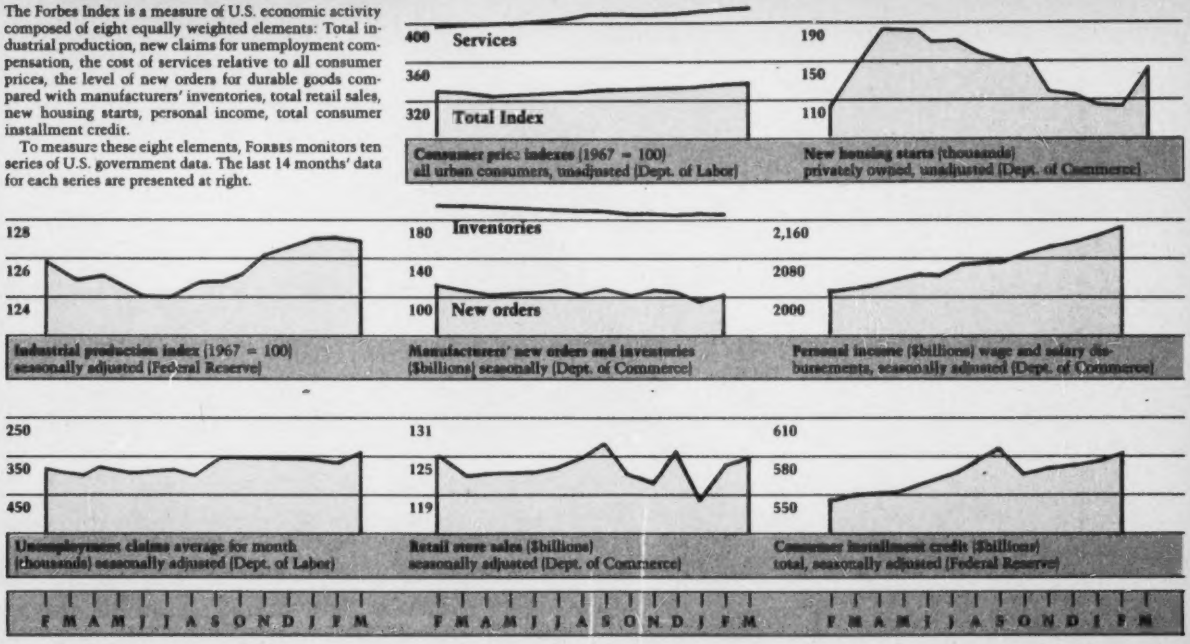
Housing shortage. The Forbes Index rose 0.2% in the latest period, but there is limited joy in the fact. There were 143,000 housing starts in March, against 102,000 in February. But the March total was down 8,000 from a year earlier, so the 12-month trailing total for new homes (one of eight elements in the Index) declined 0.4%. Another drag was industrial production, off 0.3%, reflecting a cutback in domestic auto production, from an 8.3 million annual rate in February to 7.9 million in March.

Retail sales helped the Index by climbing 0.2% from February to March. Consumers may be burdened with historically high debt levels, but that didn't stop them from purchasing some $125 billion worth of goods in the most recent month, vs. $117 billion a year ago.

The Forbes Index Components

The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.


400
360
320
Services
Total Index
Consumer price indexes (1967 = 100) all urban consumers, unadjusted (Dept. of Labor)
190
150
110
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)
128
126
124
Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)
180
140
100
Inventories
New orders
Manufacturers' new orders and inventories ($billions) seasonally (Dept. of Commerce)
2,160
2080
2000
Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)
250
350
450
Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)
131
125
119
Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)
610
580
550
Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)
F M A M J J A S O N D J F M
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A decade or so ago FORBES called accounting "the latest glamour profession." Times have certainly changed.

Blood on the ledger

By Richard Greene

THINGS ARE GETTING rough in accounting. Competition for clients grows rougher, malpractice lawsuits multiply, insurance costs escalate and recruiters find themselves outbid for bright young business school talent by rivals from Wall Street.

Now Congress is butting in. That old business-baiter, Representative John Dingell (D–Mich.), is preparing to hold House hearings on the profession, which, among other things, will explore regulating the nonaccounting business activities of accountants.

Former Securities & Exchange Commissioner James Treadway has just completed a study on the accounting profession, putting forth proposals the profession would have viewed as heresy only a few years ago. Among them: Accountants should be held professionally responsible for detecting fraudulent financial reporting in the clients they audit.

One of the issues attracting all this attention is the accounting profession's steady move into consulting: designing computer systems, engaging in strategic planning and providing financial counseling.

What's wrong with a bit of diversification? Simply this: An auditor is supposed to be absolutely independent, and the lure of consulting dollars could conflict with that. Even more significantly, an auditor who is, in effect, overseeing the work of his partner, the consultant, might be tempted to be less zealous in searching the clients' books. Says Joseph Connor, Price Waterhouse's senior partner: "There may be a lessening of professionalism that comes about through unrelenting commercialism."

Richard Derk

Arthur Andersen's managing partner, Duane Kullberg
In five years, will it really be an accounting firm he heads?

Yet the work is certainly profitable. Take Arthur Andersen, the nation's biggest accounting firm (number two worldwide, after Peat Marwick). Arthur Andersen now derives 33% of its almost $2 billion in worldwide revenues from consulting—primarily designing computer systems. Not coincidentally, Andersen's per-partner revenues are also about twice the industry average *(see table, p. 204)*.

By the mid-1990s virtually all the Big Eight firms,* which together audit all but a handful of The Forbes 500s companies and collectively grossed $13 billion last year, will likely be where Andersen is today. All will be increasingly dependent on consulting for their livelihood.

The trend persists despite criticism. Touche Ross has acquired Garr Consulting Group, a retail distribution and engineering consulting firm, and merged with Braxton Associates, a Boston-based strategic management firm. Price Waterhouse has acquired four consulting firms in the last three years. Peat Marwick bought a reported 35% interest in Regis McKenna & Co., a leading California management consulting firm.

Even as the industry moves into consulting, its legal problems from auditing mount. When a company goes bankrupt, its accountants are frequently the only target left with enough money to pay angry shareholders who want to blame someone for their misfortune.

Most of the Big Eight already face at least one such potentially devastating lawsuit. Those actions are made all the more threatening by the fact that the Big Eight are hard-pressed to get substantially more than $100 million in malpractice insurance from independent insurance companies—not enough to cover the potential losses in many of the suits in question.

At Peat Marwick the suits involve the firm's failure to foresee the insolvency of Oklahoma's Penn Square Bank. At Ernst & Whinney, problems trace to whether or not there were audit failures involving Continental Illinois National Bank & Trust Co. Touche Ross is burdened with suits arising out of the failure of Beverly Hills Savings & Loan.

Arthur Andersen alone has been tagged with a reported $137 million in payouts in recent years and now admits to refusing more and more "au-

* *The Big Eight firms: Arthur Andersen, Arthur Young, Coopers & Lybrand, Deloitte Haskins & Sells, Ernst & Whinney, Peat Marwick, Price Waterhouse and Touche Ross.*

dit risks" out of fear of more litigation.

Why are the firms so wary? When corporations are sued, it is usually the shareholders who wind up paying, but when accounting firms are hauled into court, it is the partners themselves who are personally on the line.

Litigation is one reason firms are having trouble recruiting top talent. Another is pay. Small wonder, while partners at Big Eight firms can easily make $200,000 a year, starting pay for top M.B.A.s is only about $35,000 per year, or half what's available to similarly qualified graduates at Wall Street firms like Bear, Stearns & Co. or Goldman, Sachs & Co. "When an investment banker comes to recruit," says Michael Granof, chairman of the accounting department at the University of Texas, "he's surrounded by students who want to give him a résumé. He's been talking about salaries of $80,000. The accountants who recruit come nowhere near that."

Alex Quesada

Deloitte Haskins & Sells Chairman Michael Cook
The most accounting-oriented of The Eight.

As for career advancement, it takes as long as 12 years to make partner at a Big Eight firm, vs. no more than 7 years to reach a similar ranking at a top corporate law firm—where the money is better anyway. Worse, the notion that once having attained partner status a person was set for life was itself badly shaken two years ago when Peat Marwick shoved a number of its partners into early retirement to free up cash for the Regis McKenna acquisition and other adventures.

The merger boom has further intensified pressure on the industry. When General Foods merged with Philip Morris in November 1985, Price Waterhouse lost General Foods, while Coopers & Lybrand not only held on to Philip Morris but wound up with General Foods to boot. When General Electric acquired RCA, Peat Marwick got the newly merged firm, while Touche Ross lost its old client, RCA.

The problem in such arrangements is that each of the mergers results in a net loss of audit dollars. Explains Michael Cook, chairman of Deloitte Haskins & Sells, "The audit fee of two combined firms in a merger is about 65% of the combined audit fees of the two firms taken independently." That's a terrific cost savings for the companies involved, but terrible for the accounting firms involved. Thus, the firms have been increasingly chasing after smaller and smaller corporate clients. Now some big accounting firms are certifying the paperwork on LBOs and new stock offerings.

As the pressure intensifies, competition for clients sometimes bursts into public view in embarrassing ways. Take the case of KMG, a leading international accounting firm with a large presence in Europe. Anxious to merge with a Big Eight firm, it caught the eye of Peat Marwick. But no sooner was the agreement disclosed late last year than rival Big Eight firms began seducing entire KMG national accounting operations, such as those for Spain and Japan.

Or consider the matter of William Webster, managing partner of Arthur Young & Co.'s Dallas office, who openly accused rival firm Arthur Andersen earlier this year of "lowballing" its bid to audit the books of

Rating The Eight

Since merging with international accounting firm KMG, Peat Marwick has recaptured its spot as the biggest of the Big Eight worldwide. But in terms of fees per partner—the closest thing to a profitability figure available—Peat ranks sixth. That may change if KMG partners leave.

Firm	Total fees worldwide ($mil)	% of business in: audit	tax	consulting	Number of partners	Fees per partner ($thou)	Biggest U.S. audit client
KPMG/Peat Marwick*	$2,500	60%	25%	15%	5,000	$500	General Electric
Arthur Andersen	1,924	47	20	33	1,847	1,042	Texaco
Coopers & Lybrand	1,700	61	21	18	2,946	570	Ford Motor
Ernst & Whinney	1,492	62	20	18	2,640	565	RJR Nabisco
Price Waterhouse	1,488	59	20	15	2,291	650	IBM
Arthur Young	1,427	59	26	15	2,580	553	Mobil
Deloitte Haskins & Sells	1,188	67	18	11	2,192	542	General Motors
Touche Ross	1,151	59	19	16	2,600	443	Sears, Roebuck

*Numbers for KPMG/Peat Marwick are most recent available.

Sources: International Accounting Bulletin; Big Eight Review; *individual firm data.*

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Dallas, Tex.-based First RepublicBank Corp., the newly formed $35 billion bank holding company. Webster claimed in the *Dallas Times Herald* that Andersen submitted a bid 85% below what top firms normally quote for such services—a charge that the rival firm equally vocally denied.

One of the hottest battlefields is technology: Who has the most computers, the most sophisticated software systems, the greatest ability to "interface" with a client. Boasts Larry Horner, chairman of Peat Marwick in the U.S., of his firm's 7,000 personal computers: "I believe we have devoted more time, money and effort to making our people more computer-literate than anyone else." Pish tosh, retorts Arthur Young's Chairman William Gladstone of his firm's computer audit capabilities: "I believe I can safely say we're in a whole different league." Nuts to you both, says Coopers & Lybrand's Peter Scanlon: "We have the largest computer audit library in the world—and that's no baloney."

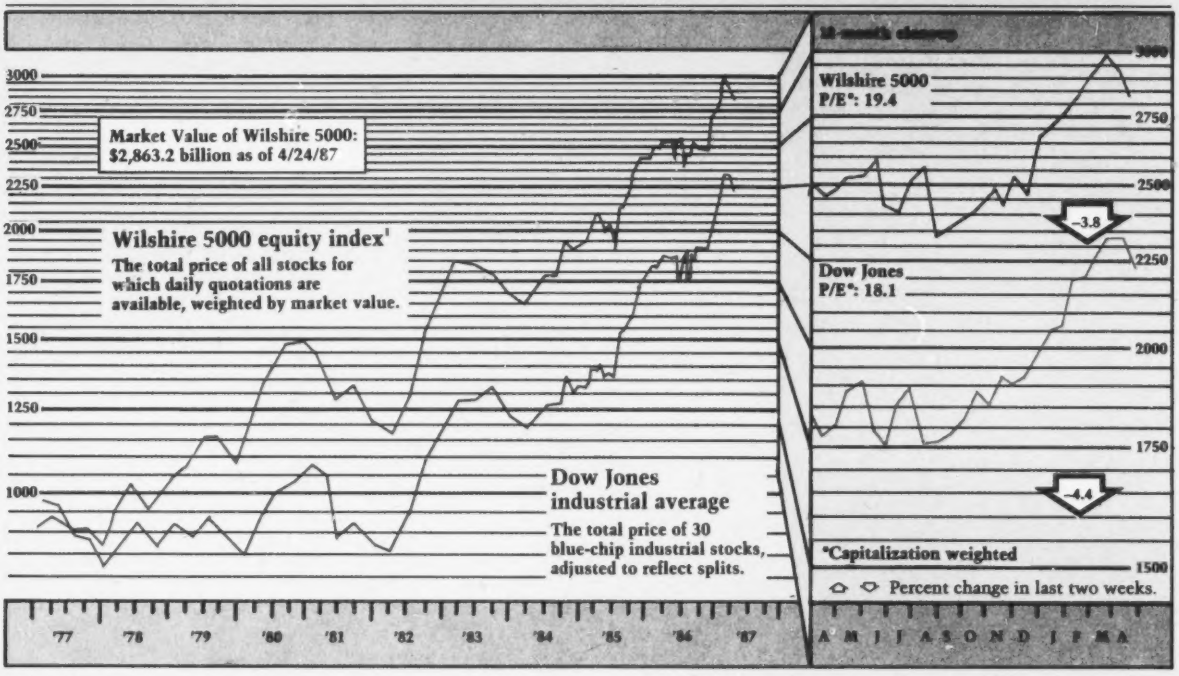
"When an investment banker comes to recruit, he's surrounded by students. He's been talking about salaries of $80,000. The accountants who recruit come nowhere near that."

Happily, accounting remains for now at least one of the nation's most admired professions, as shown by a recent Louis Harris poll of shareholders and business leaders who believed accounting to have the highest moral practices of any major profession—better than college professors, lawyers, congressmen, journalists.

Yet if something happens to that credibility, there is more at risk than simply the fortunes of the men and women in the green eyeshades. In theory, it is fine if accounting firms want to pursue opportunities in related business fields like strategic or financial consulting. There's even a strong contingent of thought that such endeavors will help the firms better understand their clients—and as a result do better audits for them. But the stakes involved are huge. In the practical world of the marketplace, certified public accountants are the only guarantors of financial integrity the capitalist system has. The further the industry strays from its roots, the bigger the chance of doing damage to its credibility with the public, and that is something from which ultimately no one can profit. ■

The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



Why investors get indigestion. In a two-week period marked by increased volatility, the Wilshire index of 5,900 issues fell 3.8% and lost $79 billion in market capitalization. Bigger stocks paced the dismal performance of the Wilshire, while smaller shares were hit even harder. The Amex lost 4.8%, the Nasdaq 4.2%. Heavy selling brought 391 exchange-listed issues to new 52-week lows. While some capital was moved into gold and gold stocks *(p. 248)*, a diverse list of 343 stocks ran counter to the falling market and hit new highs. Among them: Alcoa, Burlington Industries, Cummins Engine, Eastern Co., Gerber Scientific, LIN Broadcasting, Paccar, Prime Computer, Stanadyne, St. Joe Gold.

In two weeks the P/E ratio on the Wilshire index fell from 20.3 to 19.4. This drop, while significant, has not put stocks on the bargain counter. And for most economic sectors security analysts made slight downward revisions in their 1987 earnings estimates *(see next page)*.

Closeup On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[2]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	–5.3	–5.4	–4.3	–5.3	–4.8	–5.5
in last 52 weeks	12.7	12.1	21.8	14.2	17.8	5.2

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[3]		P/E multiple		Dividend yield		Growth profile[4]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	–6.4	–2.2	–1.4	–2.2	–3.7	–5.7	–4.8	–0.5	–0.3	–4.7	–5.3	–0.8
in last 52 weeks	13.8	34.8	50.2	22.3	13.4	10.7	7.7	39.7	52.6	14.7	14.6	23.7

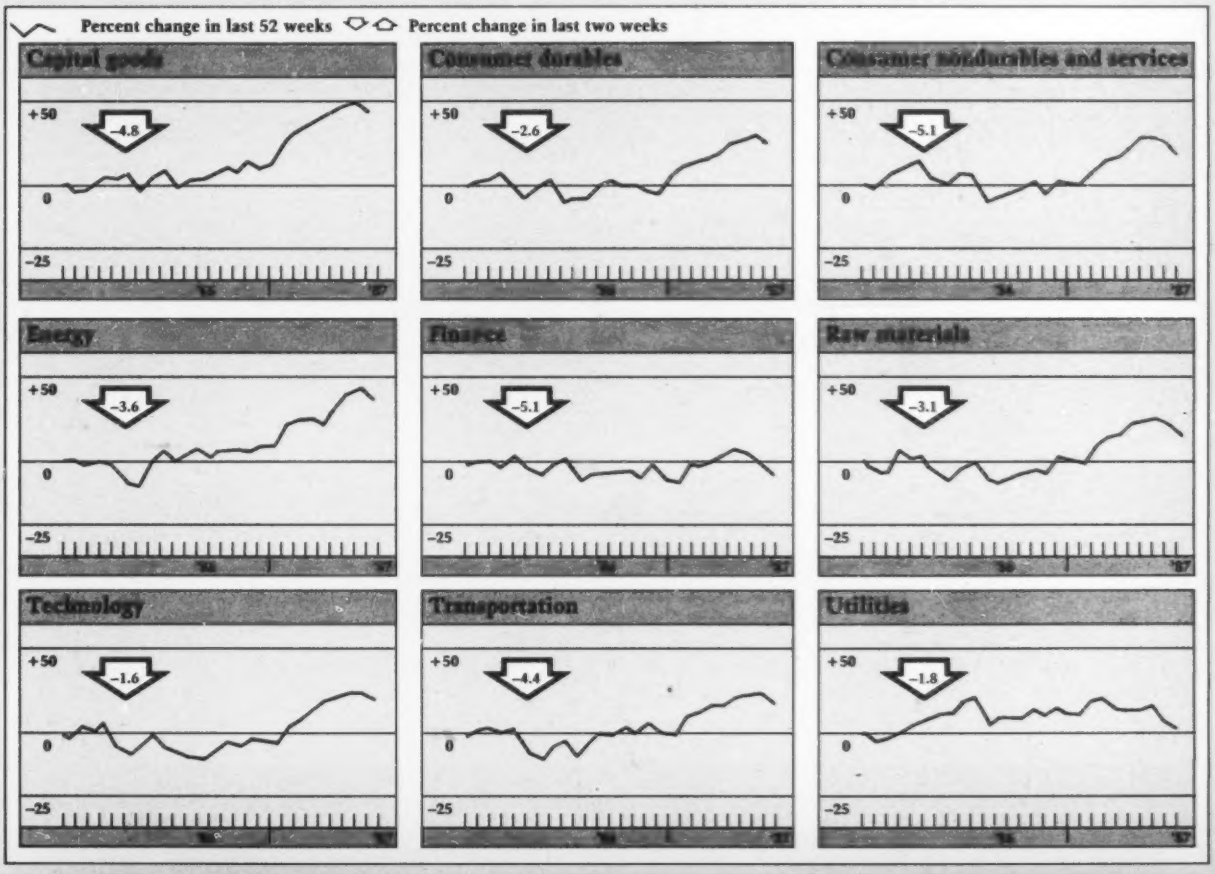
[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. [2]Based on sales. [3]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable. [4]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 4/24/87. Prepared by Wilshire Associates, Santa Monica, Calif.

Guy French

Where The Action Is

Trading places. One year ago the energy sector had the worst 52-week performance, having declined 7.8% from late April 1985 to April 1986. At the same point a year ago, finance was the third-best-performing group, having gained 42.5%. What a difference a year makes. Energy is now in first place. The oil sector shows a 40.9% increase over the past 52 weeks. Rising crude prices helped energy stocks. Rising energy prices, of course, have also contributed importantly to the runup in interest rates, which is now hurting finance shares. The finance group fell 6.9% over the last 12 months and now ranks as the worst-performing sector. Utilities, which are also interest-sensitive, began losing their appeal over a year ago and remain in eighth place.



What The Analysts Think

Countercyclical. Last year, in the midst of OPEC's collapse, oils sold for a cheap 10.9 times estimated 1986 earnings. Evidently that was too cheap, since the sector has been the hottest performer over the past 12 months. Now oils are favorites. The sector is trading at a lofty 17.5 times expected 1987 earnings.

Forecasting the Forbes 500

Performance period	Average earnings per share	P/E
latest 12 months	$2.60	18.0
1987 estimates	3.50	13.4
1988 estimates	4.11	11.5

Rank based on change in estimates	Industry	Estimated 1987 EPS	Estimated 1987 P/E	% change in 1987 estimate in 2 weeks	% change in 1987 estimate in 4 weeks
1	Raw materials	$2.38	15.8	0.99%	1.00%
2	Energy	2.64	17.5	0.44	0.06
3	Consumer nondurables	2.46	16.4	-0.13	-0.21
4	Consumer durables	3.46	13.0	-0.20	1.01
5	Utilities	2.78	9.7	-0.30	0.38
6	Finance	3.56	9.1	-0.34	-0.49
7	Capital goods	2.46	17.2	-0.38	-0.49
8	Technology	2.66	16.4	-0.50	-0.88
9	Transportation	2.37	14.4	-2.80	-4.59

Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continuously by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 4/24/87. Prepared by Wilshire Associates, Santa Monica, Calif.; IBES, a service of Lynch, Jones & Ryan, New York.

One way to play gold is via shares in mining companies. Which ones?

Risky hedges

By Michael Ozanian

GOLD MINING SHARES are in the spotlight again as inflation fears creep back. One appeal is the tremendous operating leverage in the business—which, of course, also increases the risks. The balance sheets of gold mining companies are often quite clean, but there remains the matter of operating leverage—what a change in revenues does to the bottom line.

Consider Homestake Mining, whose mines in South Dakota, California and elsewhere have an average break-even of about $260 an ounce. When gold is $360, the company is profitable; if gold is 25% higher, or $450, the profits should almost double. Giant Yellowknife Mines, with a somewhat lower break-even on its mines, is less leveraged.

Operating leverage, then, is of prime importance at gold miners. The most confident gold bulls will pick the companies with the greatest sensitivity to changes in the price of gold. As Nicolas Toufexis, a vice president of research at Prudential-Bache Securities, explains it: "The stocks that are going to hit the home run when gold goes to $600 an ounce are the high-cost producers."

Toufexis' analysis of earnings sensitivity is presented below. We show 1986 earnings—meager for many firms, since the price of gold averaged $368 in 1986. Alongside them we show a projection for 1987 earnings if gold averages $550 an ounce this year. Gold has a way to climb to make that average: It started the year at $403 and at press time was still only $464.

Strong gold prices go hand in hand with a weak dollar. At its peak in February 1985, a dollar would have purchased 263 yen or 109 milligrams of gold. Now a dollar will buy you only 140 yen or 67 milligrams of gold. The dollar has fallen 47% against the yen and 39% against gold.

Whether inflation comes back or not, the market seems convinced that $400-plus gold is here to stay. The average gold producer sells for 56 times latest 12-month earnings, the overall market for 21 times. ■

Leverage

Gold mines differ greatly in operating leverage—and hence in share volatility—because of variations in production costs. Earnings at the highest-cost operators are usually the most sensitive to changes in gold prices. The estimates show what these North American operators could earn if gold averages $550 this year.

Exch	Company	Recent price	1986 sales ($mil)	Earnings per share* 1986	Earnings per share* with gold at $550[1]	% gain	Reserves (000 oz)[2]	Stock price per ounce of reserves
o	Agnico-Eagle Mines	30¾	$28.8	$0.15	$0.73	388%	360	$1,190
o	Battle Mountain Gold	38½	91.0	0.63	1.41	124	1,510	1,097
n	Campbell Red Lake Mines	30½	142.4	0.44	1.00	128	2,025	768
n	Dome Mines	17	222.6	0.61	0.97	60	2,540	602
a	Echo Bay Mines	42½	126.1	0.61	1.61	164	5,500	348
n	Freeport-McMoRan Gold	21¼	69.2	0.34	0.97	223	2,194	400
a	Giant Yellowknife Mines	19¼	440.8	0.68	2.26	233	460	292
n	Homestake Mining	38¼	347.7	0.46	2.13	362	10,173	182
t	Intl Corona Resources	36¾	3.1	–0.11	2.04	NM	5,859	98
n	LAC Minerals	32¼	189.8	0.17	1.10	546	4,750	192
o	Lacana Mining	14¼	27.5E	0.49	0.89	82	360	759
n	Newmont Gold	33	174.5	0.42	1.08	157	12,320	280
a	Placer Development	36⅛	330.6	1.21	1.92	59	2,751	609
t	Sigma Mines	17⅝	26.5	0.56	1.32	137	610	238
a	St Joe Gold	19¾	107.3	0.25	1.01	305	1,710	358

*Excludes nonrecurring gains or losses. [1]Estimated earnings if gold averages $550 in 1987. [2]Estimate of proven plus probable reserves. E: Estimated. NM: Not meaningful. a: American Stock Exchange. n: New York Stock Exchange. o: over-the-counter. t: Toronto Stock Exchange. Amounts for Canadian companies converted to U.S. dollars.

Source: Prudential-Bache Securities.

The Forbes/TUCS Institutional Portfolio Report

Edited by Steve Kichen

The value fans haven't been doing too well. That's in contrast to 1986, when the most successful institutional stock pickers were those who focused on such fundamentals as book value, cash flow and assets. But in the first quarter of 1987 the value managers had a total return of 17.6%, which gave them a last-place finish. Managers who stuck with established medium-to-large growth stocks made out best. This management style was good for a total return of 23.5%. Stocks such as IBM, Digital Equipment, Tandem Computers, Texas Instruments and Hewlett-Packard showed significant increases in institutional holdings and all scored above-market total returns. There is, of course, an element of self-fulfillment here. The stocks were up in large part because the institutions loved them so much.

Our survey of institutional investing habits comes courtesy of the Trust Universe Comparison Service, run by Santa Monica, Calif.-based Wilshire Associates. TUCS monitors performance of some 22% of the estimated $1.8 trillion of the U.S.' corporate and governmental pension funds under professional management.

If value investing means buying cheap, then it's perhaps no surprise that value players are being left in the dust of this runaway market. By Mar. 31, 1987 the median pension portfolio was selling for nearly 19 times latest 12-month earnings and an unheard-of 2.9 times book value. Were professional investors intimidated? Apparently not. Last quarter the institutional managers allowed their exposure to common shares to rise from 54.6% to 57.2%. They were, on balance, pulling money out of stocks (note the –3% "shift in institutional holdings" in the table at right) but not fast enough to compensate for the runup in stock prices.

The median total return (capital gains plus dividends) on pension stock portfolios was 21.3% in the first quarter of 1987. This nearly matches the 21.2% total return of the Wilshire index of 5,900 common stocks and the 21.3% return of the S&P's 500.

The last TUCS report (FORBES, *Feb. 23*) noted that emerging growth stocks—mostly high-technology issues—appeared to be selling at a premium that was smaller than usual. As it turns out, those managers who emphasized such issues had the second-best results for the first quarter, a 22.3% total return.

How different managers performed

Manager style	Total return recent quarter	12 months	24 months[3]
Diversified	19.3%	22.9%	28.9%
Growth	23.5	23.3	31.1
Growth—emerging	22.3	18.6	26.1
Market timer	19.1	20.8	28.2
Sector rotator	18.7	19.8	28.3
Value	17.6	22.0	29.5

Where the institutions put their money

Segment	—Portfolio weighting— most recent quarter	previous quarter
Equity	57.2%	54.6%
Fixed income	30.0	32.3
Cash and equivalents	9.6	9.9
Convertibles	0.9	0.8
Other[1]	2.3	2.6

Equity portfolio characteristics

	Institutional portfolios	Wilshire 5000
Price/earnings ratio	18.8	18.0
Dividend yield	2.7 %	2.7 %
Beta[2]	1.04	1.06
Price/sales	1.11	1.05
Price/book	2.89	2.80

Segment performance and cash flows

Segment	—Most recent quarter— median total return	shift in institutional holdings	——Latest 12 months—— median total return	shift in institutional holdings
Equity	21.3%	–3.0%	23.9%	–5.2%
Fixed income	1.4	–3.8	8.7	–5.4
Cash equiv	1.5	0.1	6.5	8.2
Convertibles	10.7	0.6	15.9	–19.2
Other[1]	2.5	–1.7	8.9	–4.5
Total	11.2	–1.3	16.8	–3.3

Position changes: These securities had the greatest relative change in holdings over the last quarter.

Security	Increase in holdings	Total quarter return	Security	Decrease in holdings	Total quarter return
IBM	3.0%	26.1%	Norfolk Southern	–2.3%	11.7%
Digital Equip	2.4	54.3	SmithKline Beck	–2.2	10.8
Ford Motor	2.1	51.3	Pacific Telesis Gp	–1.4	1.5
K mart	1.6	43.8	Monsanto	–1.3	3.3
Tandem Comp	1.6	108.0	ITT	–1.3	12.4
Occidental Pete	1.4	23.8	Halliburton	–1.2	44.8
Gannett	1.2	29.6	AT&T	–1.0	–4.4
Westvaco	1.1	19.9	Bell Atlantic	–1.0	1.4
Texas Instru	1.1	57.5	Citicorp	–0.9	–3.7
Hewlett-Packard	1.0	35.9	Nynex	–0.9	4.6

[1]Real estate, foreign investments, venture capital, guaranteed insurance contracts. [2]A measure of risk. A stock with a beta of 1.00 tends to move up or down at the same rate as the S&P's 500. [3]Figures for 24 months are annualized.

Note: Data for quarter ending 3/31/87. Prepared by the Trust Universe Comparison Service (TUCS®), a service of Wilshire Associates, Santa Monica, Calif.

Where the institutions are—and aren't

Most overweighted relative to Wilshire 5000			Most underweighted relative to Wilshire 5000		
	% of			% of	
Security	institutional universe	Wilshire 5000	Security	institutional universe	Wilshire 5000
Digital Equipment	1.4%	0.8%	Exxon	0.9%	3.0%
K mart	0.6	0.3	IBM	2.7	4.3
Tandem Computers	0.3	0.1	AT&T	0.4	1.6
Cray Research	0.3	0.1	British Petroleum	0.2	1.2
Ford Motor	1.0	0.8	General Electric	1.5	2.3
Apple Computer	0.3	0.2	BellSouth	0.3	1.1
General Re	0.5	0.3	Royal Dutch Pete	0.7	1.5
Squibb	0.5	0.4	EI du Pont de Nemours	0.6	1.2
Occidental Petroleum	0.4	0.3	BAT Inds	0.1	0.6
NCR	0.4	0.2	Bell Atlantic	0.3	0.8

Do the institutions like Ford more than GM? Not really, but Ford's one class of common accounts for a larger portion of the total capitalization of the consumer durables sector than GM's largest common class. When GM's class E and class H stocks are added in, the firm's total capitalization is raised by more than $5 billion. During the last three months the institutions unloaded defensive stocks such as consumer nondurables and interest-sensitive groups such as utilities and finance shares. Showing biggest gains were capital goods and consumer durables.

Sector activity and top holdings

% of institutional portfolio: ■ most recent quarter ■ previous quarter

Capital goods	4.7% 4.5%	Consumer durables	5.0% 4.8%	Consumer nondurables	28.3% 28.4%
	total return		total return		total return
General Electric	22.7%	Ford Motor	51.3%	Philip Morris	19.5%
Emerson Electric	25.1	General Motors	20.3	Merck	25.3
Westinghouse Electric	16.3	Chrysler	50.4	Eastman Kodak	13.3
Caterpillar Tractor	20.6	Goodyear Tire & Rubber	31.1	K mart	43.7
Cooper Industries	33.9	Whirlpool	12.2	Sears, Roebuck	29.2
Energy	**9.9% 9.7%**	**Finance**	**13.1% 13.9%**	**Raw materials**	**13.8% 13.3%**
	total return		total return		total return
Exxon	23.6%	American Express	32.0%	EI du Pont de Nemours	34.3%
Royal Dutch Petroleum	23.4	American Intl Group	18.7	Dow Chemical	35.4
Amoco	23.5	General Re	6.9	Waste Management	32.0
Chevron	25.1	Aetna Life & Casualty	11.0	Allied-Signal	15.5
Mobil	20.2	Cigna	–3.7	Monsanto	3.3
Technology	**14.8% 14.8%**	**Transportation**	**3.8% 3.7%**	**Utilities**	**6.6% 6.9%**
	total return		total return		total return
IBM	26.1%	Union Pacific	21.7%	Southwestern Bell	5.8%
Digital Equipment	54.3	CSX	9.9	GTE	7.2
Hewlett-Packard	35.9	AMR	–2.6	Nynex	4.6
Minnesota Mng & Mfg	11.7	Delta Air Lines	14.5	Pacific Telesis	1.5
ITT	12.4	Ryder System	21.7	AT&T	–4.4

MONEY & INVESTMENTS

Beef remains the meat of choice in U.S. diets. That's bullish for cattle.

THERE'S THE BEEF

By Stanley W. Angrist

For all the noise about fitness and the anxiety about cholesterol, beef is still the meat Americans prefer over anything else they kill for the table. It's true that beef has lost market share. But most of the gains poultry has made in the last six years have come at the expense of pork, not beef.

Still, a loss there has been. And on top of that there has been an important shift in taste over the years among beef eaters as a group—down with choice cuts, up with hamburger. Result: The record beef herds of 1975 were liquidated on a grand scale in 1978-79.

But there's evidence that herds are being rebuilt. If that continues, there will be created a condition that cattlemen call "whiplash." To understand its workings you need to know a few facts about the cattle cycle. About 1.4 head of breeding inventory are required to produce a calf. Thus, when cattlemen decide to produce 1 million head fewer, they bring to market 1.4 million head more. This is why beef production has been near record levels in recent years, while cattle numbers have declined.

Stanley W. Angrist is a commodity speculator, consultant and longtime observer of the commodity markets.

The same leveraging effect occurs, of course, when the cycle heads the other way. When cattlemen want to expand their herd size by 1 million, they must withhold 1.4 million head from the number they would normally bring to market. The last time this kind of change took place was in the 1978-79 cycle. The table *(below)* details the impact of that change on supplies. The effect on prices? In 1978 choice steers were selling for about 52 cents a pound, while feeders sold for about 59 cents. By 1979, when the whiplash had taken full effect, choice steers had moved up 29%, while the average price of feeders had increased 41%.

If cow/calf operators stop liquidating herds this year, beef supplies will drop sharply. Beef/cow inventories are now 9% below the 1979 level. So, if 1987 should become the whiplash year in the cycle, slaughter of cows and heifers could drop even more dramatically than in 1979. The table shows the potential effect on supplies.

Evidence of herd rebuilding is coming in.* The January *Cattle-on-Feed Report* showed that there were 10% fewer heifers in feedlots than last year, as opposed to 2% fewer steers. Cow slaughter has remained below year-ago levels each week since December 1986. Wholesale cow beef traded at a $30 discount to choice steer beef in November. The difference narrowed to $7 in January. These factors suggest that the holdback has begun and that 1987 will be the whiplash year.

If this is the whiplash year, there are a number of ways to play it. In the Apr. 20 issue, I described the synthetic long position that can be created using options. The current cattle situation looks like a perfect application for this technique. Buy the August 64 cattle calls and sell the August 60 puts at the biggest credit you can get. Then, even if August cattle doesn't make a strong advance but winds up between 60 and 64 cents, you will have a profit. The margin will be the debit created by the option purchased plus the futures margin that has to be put up on the short sale. I would limit my risk to no more than $600. The trade has unlimited potential profit in an advancing market. ■

* *Commodity Information Systems, a fundamentals-based market service, has prepared a detailed analysis on the cattle market. You can get a copy and a two-month trial subscription to its selection program ($25) by calling 713-320-0112.*

If beef herds expand . . .

The cattle market completed its last move from herd liquidation to herd expansion in 1978-79. Note that as heifers and cows were held back from slaughter, beef supplies fell precipitously. Cattlemen call it the "whiplash" effect. If herds expand in 1987, the whiplash could be even stronger, because total inventory of cattle (figures not shown) is 10% below 1979 levels and beef/cow inventories are 15% below 1979 levels. (Numbers are in millions of head, except beef production—in billions of pounds.)

	1978-79 whiplash			Potential 1987 whiplash		
	1978	1979	% change	1986	1987*	% change
Steers	18.5	17.4	–6%	17.5	16.5	–6%
Heifers	11.8	9.7	–18	11.1	9.1	–18
Cows	8.5	5.9	–31	8.0	5.5	–31
Totals			–15%			–15%
Beef Production	24.0	21.3	–11%	24.2	21.5	–11%

*Estimated.